



Report for Quarter Ending May 31, 2003

TO: United States of America Agency for International Development
Contract # 168-C-00-03-00101-00, March 1, 2003 to August 31, 2004
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USAID Bank Supervision Project

Contract Objectives:

The overall objective of this contract is to further develop the supervisory capacity and supervisory culture of well-respected professional supervisors who are empowered to carry out their duties and responsibilities as required by their banking laws. A critical decision, that's still subject to on-going discussions, is the merger of both the RS and Federation banking agencies into one integrated state agency under the umbrella of the Central Bank. The final resolution of this issue will affect the delivery mechanism of some tasks within this task order.

The Specific Objectives of this contract are to:

- 1) Facilitate the legal, operational, political and financial transition of both the RS and Federation Bank Supervision Agencies, to the greatest extent possible, into one integrated agency as part of the Central Bank to ensure long-term independence and sustainability;
- 2) Strengthen the operational capacity of the agencies, which includes management capacity, training and staffing development as well as financial sustainability as the sector changes;
- 3) Implement the recommendations of the anti-money laundering working group and assist the agency in combating money laundering as the sector and agency evolve;
- 4) Assist the local authorities in the resolution of problem banks, *and develop the capacity of the Deposit Insurance Agency to address the resolution of problem banks.* **(The wording in Italics should be changed to: “and develop the capacity to perform payouts on insurance events and to ensure recovery of funds during the bank resolution process.”)**

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Statement of Work

This task order will continue in many areas of the current contract with particular emphasis in the following areas:

(Notes:

- *Contract SOW omitted two items from Objectives that have been **inserted**: “I-a: Consolidation” & VII: “Anti-Money Laundering and CFT”.*
- *> Denotes **projected timing of effort** when Work Plan drafted.*
- ***Measurable Goals** are listed at the end of each listing of work.*
- ***Achievements** follow Measurable Goals.)*

I. INSTITUTIONAL DEVELOPMENT

I-a. Facilitate the consolidation of bank supervision into the CBBH or an independent state level agency. * > Ongoing effort

- 1) Participate in working groups to achieve consolidation into an effective, independent and sustainable unit.
- 2) Initiate actions in support of this objective.
- 3) Work with others on legal changes to Laws on CBBH, Banks and Banking Agencies. Bring expert attorney to develop draft of legal framework in conjunction with others.
- 4) Actively participate with others on Organizational Changes needed to accomplish objectives.
- 5) Provide TDY to assist with Human Resources issues, including Change Management, and a re-start of efforts on Examiner Accreditation, Performance Evaluation, etc.
- 6) Provide Expert on IT, Consolidation Database and software to upgrade usability of data for analysis.

*** (See Attachment:
Action Plan to Consolidate Bank Supervision.)**

Measurable Goals:

- Two banking agencies will be consolidated and operating as one with two locations (*requires multi-party agreement and commitment*).
- Laws and Organizational Changes will be substantially accomplished.
- Human Resource initiatives on Examiner Accreditation and Performance Evaluation will be in operation.
- Consolidated database and upgraded software will be in operation for FBA, BA-RS, DIA and CBBH.
- Plans will be initiated to streamline the reporting process.

Achievement:

No measurable achievement at this point.

- This matter has been discussed with several parties, including the officials of the two banking agencies and the Governor of the Central Bank. There is general agreement on the objective, issues and plans. The Governor has delayed the decision-making process for the appropriate timing and parties to be in place. He has agreed to hold a meeting of the Strategic Committee in June or early July to determine the best structural location and get a decision to support the legal and organizational changes. The Governor agreed that September appears to be the appropriate time to initiate major actions in the consolidation process.
- Project advisors have planned a brief diagnostic of the four IT systems in use at the two banking agencies, deposit insurance and Central Bank. This will provide a base for an in-depth analysis and design for a consolidated database in September-October 2003.

I-b. Improved communication amongst staff within the banking agencies and with the Central Bank.

- 1) Active participation in bank supervision coordination meetings.
 >Ongoing effort.
- 2) Encourage the establishment of more specific avenues of communication and reporting beyond present coordination meetings.
 >Ongoing effort.
- 3) Invite CBBH representatives related to banking and coordination of bank supervision to training for bank supervision agencies (e.g., Overall Conclusions and Bank Ratings in June-03).
 >June-03 and Ongoing.

Measurable Goals:

- Plans will be initiated to develop an internal communication process for policies, procedures and other issues that is numbered and tracked. Initially, this may be paper-based but the goal will be to use the website or electronic network.

Achievement:

Nominal achievement during first quarter of Contract.

- Project Advisors attended a Coordination Meeting on May 22nd. Consolidation was one of the agenda topics. Several participants indicated a need to proceed on reaching a decision on the structural location and needed legal changes.
- CBBH representatives were invited to participate in the June 9th Training Workshop.

I-c. Develop supervisory tools through policies, procedures and training to ensure more effective supervision of banks and their subsidiaries/affiliates.

Training:

Note: Training will consist of a mix of seminars/workshops, on-the-job training (OJT), and other methods to complement their learning effort, build consistency and balanced for greatest effectiveness and efficiency. The project will likely not achieve all proposed training items, but will adjust scheduling and resource commitment in response to Agency priorities in recognition of changing needs and staff availability. Additionally, some of the proposed training will be covered through guided self-study, other providers and external sources. Agency staff will be included as (apprentice) instructors as appropriate to build internal capacity. Seminar and workshop related reference materials will be prepared in English & local languages.

- 1) *"Overall Conclusions and Bank Ratings"*. Revise text and case studies to current and projected banking situation in BiH to emphasize the changing risks, additional considerations for developing conclusions and ratings. Include "ownership" issues, potential impact positive and negative. Contrast different performance results between banks in same market and causes of difference. Use Analysis Form implemented in Off-site training in 2002. Emphasize forms and methods that can improve efficiency. Introduce corporate and bond ratings by Rating Services (Moody's, Fitch, S&P) and uses/impact.
>June-03, for all BS staff, and representatives of DIA & CBBH.
- 2) Provide OJT/workshop in Analysis for Off-site determinations of Bank Ratings coupled with Targeted Onsite examinations. Build on training in 2002 and to complement training above.
>June-03, for Off-site and newer Onsite staff, and reps. DIA & CBBH.
- 3) Provide training on the potential impacts of affiliates/subsidiaries on bank and need to consider the risk as part of effective supervision. Introduce by examples in case studies used in *"Overall Conclusions and Bank Ratings"* in June-03. Provide more specific training at later seminar/workshop, likely combined with related training issues.
>TBD_____.
- 4) Locate outside seminars for limited number of staff to attend to increase their specialty training; provide support for sharing such knowledge by internal briefing of associates. Example: Bank Supervisors Central and Eastern Europe, Basel/Toronto Centre, National Bank of Poland, etc. >Ongoing.
- 5) Accounting issues/International Accounting Standards (IAS), especially on mergers, goodwill and acquisition expenses. Ongoing as issues surface, brief workshops in conjunction with Offsite Analysis training and by outside seminars. OJT follow-up pertaining to most relevant standards, case study approach with examples brought by participants, focus on application of standards and key issues within each, and inadequate implemented standards in banking system.

>June-03, ongoing, ad hoc, include with other training efforts.

- 6) Fundamentals seminar(s) - Courses (previously developed and presented) for newer examiners: proposed subjects include accounting, credit, liquidity, internal control and internal/ external audit, and repeat of “Ethics & Professional Conduct”. Recognizing that newer staff members have some field experience, combine introduction and intermediate courses in most instances. Include agencies staff as participating instructors on repeat courses.

>Q4-03 through Q2-04 depending on staff availability and other priorities.

- 7) On-site examinations manual. Drafts are partially completed. BA-RS has numerous recommendations from use in examinations. FBA has used partially but not developed specific list of recommendations. TDY with interaction with supervisory personnel could substantially complete. Advisors will emphasize need for a joint working group of examiners to complete and get approval.

>Q4-03 and Q1-04.

Measurable Goals:

- Most training topics listed will be achieved through a mix of methods.
- Onsite Examination Procedures based on CAMELS will be in use for guidance or reference.
- Project will provide training and reference materials that bank supervision can use in continuing its learning and development efforts, including study guides and contacts with external education sources.

Achievement:

- **Project assisted FBA prepare and deliver four days of training to another government agency on financial crime, money laundering and investigations in banks. Six FBA officials/examiners participated as instructors with facilitation by the Senior Project Associate. After presenting the legal framework, theory and description of problem, they presented case studies to illustrate how to investigate and document. This training of others also helped FBA develop internal training capacity and confidence.**
- **Project prepared the revised Training Workshop “Overall Conclusions and Bank Ratings” for delivery the week of June 9th. It was modified from the course delivered January 2000 to increase emphasis on: management evaluation, contrast of management systems, bank failure versus satisfactory performance and causes, ownership issues, changes and new products, accounting issues and an introduction to ratings by Rating Services. Numerous case studies and handouts were developed to support or reinforce the training.**
- **Project assisted Officials and Examiners prepare for external seminars on Basle II – Capital Accords, Consolidated Supervision, Crisis Management and Advanced Credit Analysis.**

<p><i>I-d. Strengthen the supervisory capacity of senior management and field supervisors to provide for a safe and sound financial sector in Bosnia by <u>anticipating challenges</u>, especially in <u>new markets, products and risk areas</u>.</i></p>

Training:

- 1) Provide seminar on new products in general and determining and managing risks. Include presentations on specific new products expected and how to evaluate risk.
- 2) Case study and/or workshop presentations by professional staff of examples they have found. (Note: 8 RS banks have established Investment Departments with no apparent institutional capacity.)
>Plan Q4-03 through Q2-04 and ongoing search for external seminars.
- 3) “*Securities, Managing Investments Risk*”(new). All professional staff. Key focus on banks’ likely role in market and potential risks. This subject also relates to consolidated supervision issues. Securities Commission professional staff should be invited to help with mutual understanding of roles and issues. Further development of the action plan and timing on this area is needed.
>Project early 2004 (Q1-Q2).
- 4) Locate outside seminars on new products, investments and associated risks for limited number of staff to attend, develop specialist roles and to be resource to others on return. Development of specialist skills should be in addition to general examiner competency that must be maintained by rotation of assignments and full training.
>Ongoing effort.

Achievement:

No measurable achievement in first quarter of Contract.

Human Resources:

- 1) Restart joint-working group on Examiner Evaluations, Examiner Training and Development, and Accreditation for Examiners. Coordinate in conjunction with developing Human Resources and a Performance Management process within consolidated bank supervision in CBBH or state level agency.
>Q3-03 through Q2-04, in coordination with consolidation.
- 2) Assist in establishment and training for the “Development Office” to build research, detection and identification capabilities for new risks and threats, develop counter-measures to manage risks and develop staff expertise to meet the changing challenges. This includes managing internal training and development of supervisory staff competencies to meet the challenges. (*Action Plan for this area needs to be developed in conjunction with next item above in consolidation. A proposed statement of duties and responsibilities has been drafted.*)
- 3) Provide additional training to Senior Project Associate in this area, focus more of her time on managing the Human Resources and Training initiatives and assisting with the overall effort in this area.
>Begin Q2-03.

- 4) Associate will develop and implement a process for managing the training and development of new supervision staff. This process will be designed to build into the overall development and training process leading to Examiner Accreditation (*and Analyst Certification*). This process will be developed as an integral part of bank supervision with the ability to link into future development of Human Resources function.
>Initiate Q2-03, Ongoing.

Measurable Goals:

- Processes for Examiner Accreditation and Performance Evaluation will be in operation that builds a culture of professional development and institution building.
- New “Development Office” will be established or in the process of establishment.
- A Training and Development Process for new examiners will be initiated that can be sustained and built upon.

Achievement:

No measurable achievement in first quarter of Contract.

I-e. Develop an improved ‘early warning’ capability that better integrates various indicators of a bank’s condition so that the banking agency can address potential issues earlier.

- 1) Work with appropriate parties to develop a strategic plan for a consolidated database that is shared by Bank Supervision, Deposit Insurance Agency and CBBH. (*Need Expert to evaluate present database capabilities, make recommendations and initiate a Steering Group in developing the plan. Involve: Representatives of 2 Agencies, CBBH, DIA & IT from each, Expert. This is a part of the attached Action Plan on Consolidation.*)
>Estimate beginning September 2003.
- 2) Work with appropriate parties to reduce the number of separate forms submitted by banks and to ensure that the needed information is received. (*This will involve reviewing the need and uses of forms, the frequency of reporting, consolidating some forms and eliminating others. Involve: 2 Agencies, CBBH, DIA and 2-3 representatives of commercial banks via Bankers Assoc. See attachment.*)
>Begin Q1-04.
- 3) Off-site analysis. Joint training in off-site workshop, to ensure compatibility and accord in standards of analysis; with IT, development of more sophisticated tools and more automated MIS, including such features as edit checks and other comparable populations for peer comparison. (*See Attached Action Plan.*)
>Include in June-03 and (..?..) in conjunction with consolidation.

Measurable Goals:

- Databases will be consolidated and operating.
- Early Warning System will be improved and more efficient.

- Offsite Analysis will be more effective in surveillance and risk management, and provide more efficiency in scheduling and prioritizing the use of human resources.

Achievement:

No measurable achievement at this point.

I-f. Expand the banking agencies abilities to other related financial sectors. Three such sectors are insurance, investment banking and investment or money management funds. As banks expand into other lines of business, the banking agencies will need to keep abreast of these developments, and to build up in-house expertise to identify the kinds of risks that these lines of business can cause depositors.

- 1) Provide training on Bank Investments as part of Funds Management and Liquidity. Include information and training on Market Risks, including price, FX, Interest Rate Risk, Swaps & Forwards, etc. >Plan Q4-03 or Q1-04.
- 2) Provide training on investment management by banks for clients (securities trading, management of PIFs, brokerages, brokerage, stock exchange, risk management issues, etc.). Include use of applicable ratings (Moody's, Fitch, S&P) >Plan Q4-03 or Q1-04.
- 3) Locate outside seminars on targeted issues above. >Ongoing effort. (also Securities training proposed under Training section)

Measurable Goals: (combine f. & g.)

I-g. Develop supervisory capacity to recognize and identify the inherent risk (capital, asset quality, earnings, liquidity, risk management and internal controls) at the consolidated level, as well as individual subsidiaries and/or affiliates level.

Training:

- 1) Present training on recognizing risks in consolidated and subsidiary/affiliate relationships, as noted above in I-c-3.
- 2) Locate external seminars as noted above. >Ongoing effort.

Measurable Goals (f. & g.):

- Bank Supervision will have regulation and/or procedures implemented in this area.
- Bank Supervision will have more technical knowledge and risk management competence in these new and changing areas, and will demonstrate by addressing issues promptly.
- Regulation or Procedures will be developed to provide guidance to supervision.
- Communication avenues will be established with other regulators to enhance cooperation and joint efforts.

Achievement:

No measurable achievement at this point.

- **Advisors have discussed these issues with counterparts and project actions in 4Q-03 and early 2004 regarding Consolidated Supervision and relationships with other regulators.**

II. REGULATIONS

Recommend regulatory changes to facilitate improved bank supervision. As supervisory activities expand, current regulations will need to be revised and enhanced, and new regulations created to incorporate the necessary components for an effective and efficient legal, regulatory and judicial framework.

- 1) Review laws, regulations, practices, etc. to include amendments when the laws/regulations are being amended for consolidation of bank supervision. Monitor and anticipate problems occurring involving laws, regulations and procedures and develop an ongoing list of such changes needed.
>Ongoing - effort with agencies, CBBH.
- 2) Review laws, regulations, practices, etc. in view of new products/services, subsidiaries, ownership structures, etc. that may impact the ability to supervise effectively, or may obstruct needed new products and changes.
>Ongoing effort as such issues are anticipated or arise.

Measurable Goals:

- Evaluation will be performed of changes needed, and guidance on priority issues will be provided on laws, regulations and practices during consolidation changes.
- Enhancements will be made to laws, regulations or procedures in these areas.

Achievement:

No measurable achievement at this point.

III. LEGAL FRAMEWORK

III-a. Improve the legal protection for bank agency staff (management and supervisors) so they are not at risk of personal liability when carrying out their official functions.

Included in “umbrella” and consolidation work (*see “b” & attachment*).

III-b. Influence the courts to demonstrate appropriate judicial deference to the expertise of the banking supervisor as is common in most western economies.

Project will find and focus on certain technical matters within its expertise and work with OHR/others to include in their contact and education of police, prosecutors and courts.

NOTE: Scope of this item could be very broad, outside our control and difficult to attain.
Possibility: locate attorney/judicial expert with related experience to work joint with OHR sponsored seminar for judges, prosecutors, investigating police, et al.
Estimate: Combine timing with Legal work on Consolidation, Q3-4-03.

Measurable Goals: (a. & b.):

- Provide training and reference materials to prosecutors and judges.
- Provide training at University of Law/Criminology (future benefits).

Achievement:

- **Project Advisor met with several representatives of organizations, including OHR and CBBH Governor to discuss ongoing threats against FBA and its officials.**
- **Advisor assisted OHR on actions resulting in OHR providing a “Legal Opinion” to Prosecutors and Court, and providing a “Court Monitor” to monitor legality of court proceedings.**

III-c. Work on regulatory changes, on an as needed basis, that might involve non-bank financial institutions, e.g., micro-finance organizations or savings and loan institutions.

- 1) Review legislation (law and regulations), developing practices and areas of population under-served in current financial environment.
>Ongoing efforts as initiatives develop.
- 2) Cooperate with USAID FSBAT project, World Bank Local Initiatives Project, MOF, et al, on changes in laws, regulations for non-bank financial operations, such as Micro-finance evolves and savings/credit are considered.
>Ongoing efforts as initiatives develop.

Measurable Goals:

- Provide support and recommendations to appropriate groups.

Achievement:

No measurable achievement at this point.

- **Project Advisor met with FSBAT and Local Initiatives Project representatives to discuss pertinent laws and actions planned.**

IV. INTEGRATED SUPERVISION

See actions planned under Institutional Development section and Attachment (*Action Plan to Consolidate Bank Supervision*).

IV-a. Encourage and facilitate cooperation and integration of functions, to the greatest extent possible, between the RS and Federation banking agencies.

- 1) Propose a joint agency examination team to examine a bank in each entity. The objective will be to enhance cooperation in supervision objectives, harmonize supervision approach, procedures, developing conclusions and ratings process.
>Q2-3-03.

- 2) Propose joint agency AML targeted examinations.
>Q2-3-03.

Measurable Goals:

- Evidence of joint efforts in bank supervision, training and development of processes.

Achievement:

No measurable achievement at this point.

IV-b. Work with the Central Bank to better integrate the bank supervision functions between both entities, possibly creating one combined agency at the state level.

Included in attached Action Plan on Consolidation.

Measurable Goals:

- Bank supervision operating as one supervision unit (*as above*).

Achievement:

No measurable achievement at this point.

V. DEPOSIT INSURANCE

V-a. Encourage and facilitate cooperation between the bank supervision agencies and the BiH Deposit Insurance Agency.

- 1) Actively participate in working group to update Agreement on Cooperation between bank supervision agencies and BiH DIA (*agency at state level*). Obtain full support and cooperation of key officials.
>Begin Mar-03, complete Jun-03.
- 2) Participate in the development of procedures in regard to an Insurance Event, Payout and Recovery, and ensure the execution needs are included in the Agreement on Cooperation. (See comment below on Resolution and Payout function.)
>Begin Mar-03, complete Jun-03.
- 3) Assist in development of compatible IT and unified database (see attached Action Plan on consolidation).

Measurable Goals:

- Evidence of cooperation or joint training between supervision and insurance.
- Joint development of needed payout procedures and recovery process.
- Shared database of bank reported financial data will be implemented.

Achievement:

- **Modified Agreement on Cooperation drafted, ratification expected in June.**
- **Project provided payout procedures excerpted from Provisional Administrator and Liquidator Manuals to DIA. Working group formed on payout procedures and resolution/recovery process. Project plans TDY Expert to review and make recommendations in September. Needed training will be included.**
- **A brief diagnostic review of IT databases is planned for late-June with an in-depth analysis and design in Sept-October 2003.**

V-b. Strengthen the links and capacities of the Bank Supervision Agencies, the Central Bank and the Deposit Insurance Agency. Ultimately, this may lead to the integration of all or some of these functions into one unit.

- 1) Continue active participation in Coordination Meetings.
- 2) Participate in Technical Working Group on Consolidation and initiate actions described on Attached Action Plan on Consolidation.

Measurable Goals: (see other consolidation items).

V-c. Strengthen the capacity of the Deposit Insurance Agency to protect the Insurance Fund and ensure the maximum recovery of funds paid out for insured deposits.

- 1) Resolution and payout function –
Provide copies of procedures developed for payouts during Provisional Administration and Bank Resolution. Work with Banking Agencies, Deposit Insurance Agency and Central Bank to develop organizational structure, authorities, processes, and internal controls to ensure that the significant experience and expertise of the Banking Agencies is retained and utilized, and that the interests of the Deposit Insurance Agency, including integrity of the deposit insurance fund, are protected. Recommended vehicle is a working group (with project advisors as members) for development of necessary policies and procedures for cooperation and payout during an Insurance Event.
- 2) Utilize TDY Expert to review Payout Procedures in existing Manual of banking agencies and adapt for effective and efficient use by DIA. Expert would also review the Provisional Administration and Liquidation process by banking agencies for appropriate involvement of DIA to protect their interests in recovery of any funds paid out. Expert would initiate or participate in necessary training to prepare DIA for such eventuality.
>Initiate Mar-03, provide training as any uninsured pay-out event occurs- a possibility in 3Q-03.

- 3) Participate with representatives of bank supervision and deposit insurance to develop a process for monitoring of Provisional Administration and participation in Liquidation Administration when there is a risk of an Insurance Event or an Insured Payout has occurred.
- 4) Assist the bank supervision agencies develop training-OJT in an uninsured bank in Provisional Administration or Liquidation to illustrate the process above to DIA.
- 5) Include DIA professional or analytical staff in technical training seminars/workshops as appropriate.

Measurable Goals:

- DIA has effective procedures to prepare for and execute a payout event.
- DIA has adequate understanding of Provisional Administration and Liquidation to participate in the process, protect its funds and effect maximum recovery.
- DIA participates in selected supervision training.

Achievement:

- As noted above, project has provided payout procedures and plans for TDY Expert to review, recommend and train in September-October 2003.
- DIA staff invited to the Workshop June 9th.

VI. PROBLEM BANKS

VI-A. Facilitate the timely and effective resolution/liquidation of problem institutions, particularly ones taken over by the banking agencies.

- 1) Review practices and discuss ways to overcome obstacles and increase the efficiency of bank resolution. Document “lessons learned” for use by these and other CEE bank supervision units.
- 2) Close-in advisor support “ad hoc” and as requested on interventions in process or anticipated.

Note: Hercegovacka Bank in Provisional Administration will likely be transferred to FBA in July 2003. Advisors will assist FBA develop a Strategy and Action Plan to deal with this unusual problem.

Note: BA-RS may need assistance in Q3 or Q4-03 (Deposit Ins. Requirement)

Measurable Goals:

- Advisors assist BA-RS on problem banks, enforcement and implementation of bank resolution, including Provisional Administration & Liquidation Procedures.
- Bank Supervision will have the competence to manage problem banks, intervention and resolution without support (end of contract period).

Achievement:

- **RS Resident Advisor assisted officials of BA-RS plan for the takeover of a bank having increasing liquidity problems. This bank was affected by its primary owner being intervened by OHR in Bosnia and subsequent arrest of the principal by Serbian officials.**

VI-b. Ongoing refinement of the legal/regulatory framework to ensure the banking agencies and Deposit Insurance Agency have appropriate authority in problem bank resolution and liquidation.

- 1) Review obstacles and practices to determine needed changes in legal/regulatory framework to improve efficiency of bank resolution.

Measurable Goals: *(as above).*

VII. ANTI-MONEY LAUNDERING and COMBATING THE FINANCING OF TERRORISM

Implement the recommendations of the anti-money laundering working group and assist the agency in combating money laundering as the sector and agency evolve.

- 1) Convene the AML Working Group on Banking Sector and update the status of issues and Recommendations. Include a representative of OHR to participate, hopefully as Chair, to ensure participation of all representative parties. Determine needed actions and engage the appropriate parties.
>Initiate actions in May 2003, complete status review of recommendations and develop new recommendations and initiatives to improve the effectiveness of AML / CBT efforts.
- 2) Participate in and support training in Financial Crimes, Anti-Money Laundering and Combating the Financing of Terrorism.
>Apr-03 and ongoing.
- 3) Actively participate in efforts to further these objectives in legal framework, regulations, cooperative agreements, examination procedures and practice. Determine status of Law on AML – CFT circulated in 2002 and work to get implemented.
>Re-start effort in Apr-03, and ongoing.

Measurable Goals:

- Working Group addresses prior Recommendations and acts to improve AML & CFT compliance results.
- Bank Supervision process includes initiatives to improve compliance within their authorities and assist others to develop higher overall compliance.

Achievement:

- **Resident Advisor and Senior Project Associate obtained a commitment from OHR to provide a Chairperson for the Working Group. A meeting was held with two officials in May to plan continuation of the Working Group. A letter has been drafted to send to Working Group members requesting that they review the Recommendations previously published in booklet form, determine their status and respond. A meeting will be scheduled to determine follow-on actions needed.**

- **Senior Project Associate advised and facilitated FBA in developing and presenting training to 35 members of the Federation Intelligence and Security Agency (FOSS) on investigation of financial crime in banks, money laundering and terrorism financing. Resident Advisor commented on international efforts, cross-border issues, communication and cooperation.**
- **Resident Advisor met with US-DOJ/ICITAP Expert to review a proposal under development in Republika Srpska regarding a company registration process to prevent the fictitious shell company problem in money laundering.**

NOTE: Given the dynamic nature of the Bosnian banking sector, and the Bosnian political environment in general, USAID reserves the right to conduct a reassessment and clarification of the project's goals to more accurately reflect the changing environment over the period of the contract.

Attachment to USAID – BearingPoint Contract 3/1/03 Statement of Work:

Action Plan to Consolidate Bank Supervision into CBBH or State Agency.

***This requires multiple parties for decision-making, initiatives and achievement.
The degree of USAID Bank Supervision Project involvement requires agreement and cooperation with others having a role in the anticipated undertaking.***

Key parties for Decision to consolidate and the final structure:

- CBBH Governor and Strategic Working Group (*composed of CBBH Governor, a Vice-Governor, Directors of two banking agencies, Ministry of Treasury [state], and MOF of each entity.*) This group has not met and discussed this matter since before the elections. It has been hampered by lack of full representation, i.e., one or more Ministries have had a vacancy.
- Government officials, Parliament and political parties agreement or opposition.
- International Community. This should be easy sell. IMF and World Bank have placed this high on their items recommended to the governments although they have not been specific as to the form or structural location.

CBBH Governor plans a meeting as soon as full representation can be reached.

Once a decision is reached, the following should be done:

A new ***Consolidation or Transition Working Group*** will probably be formed to manage the specific transition steps. It may be a reconstitution of existing Working Groups.

Legal changes:

The Law on CBBH, Laws on Banking Agencies and Laws on Banks will have to be changed to reflect the consolidation either into CBBH or other structure. Other laws may need reference changes. An outside attorney experienced in such matters should work with the attorneys and others representing each party as needed:

>Estimate to begin:

***Sept-03, 4 weeks for outside attorney, (USAID- Bank Supervision Project)
with 3-4 months timeline for completion.***

Organizational changes:

A number of decisions will need to be made as the new organizational structure is developed. Most likely, a person will be named as CBBH Director (or Vice-Governor) for Bank Supervision on a par with other Vice-Governors reporting to the Governor. Governor is key to this decision, with Board discussion and ratification. Council of Ministers and Governor are presently in process of determining the new Board and changes effective in August 2003. Hopefully, these organizational decisions will not need to wait for the new board, or it won't happen before Sept-03.

The two entity areas will probably remain mostly intact initially, with a gradual restructuring of resources in relationship to changes in banks within one economic space. Some supervision resources will need to remain in Sarajevo and some in Banja Luka as there will continue to be a need to have local representation. Most banks will be head-quartered in these two cities, with the Federation banks holding over 80% of assets.

Some resources presently located within the two banking agencies may be better located at the CBBH under the appropriate Director or Vice-Governor for Bank Supervision. And, it is likely that some resources may be shared with other CBBH areas.

Some resources presently located within the two banking agencies will be redundant and will need to be offered alternatives within bank supervision, CBBH or a severance package. This will be one of the more difficult issues under existing laws and practices. It will also be a potential adverse impact on morale and performance if not handled carefully. “*Change Management*” Human Resources expert should be used to assist management in addressing personnel concerns.

>Timing to begin addressing these issues:

Organization changes: Sept-Oct-03,

HR/ Change Management: Oct-Dec-03 (USAID BSP).

Human Resources:

The consolidation offers the opportunity to initiate the development of Human Resources, Performance Management process, Training and Development and related areas that the present banking agencies cannot afford with their limited resources, and that the CBBH has not reached in its development. Banking Agencies have had limited training in this area and initiated some actions towards Examiner Development and Accreditation.

Full implementation of these areas will take a long time, perhaps 2 years, depending on the desired degree and rate of development and implementation. This is likely to be developed in specific blocks, e.g., Examiner Development and Accreditation, Training and Development capacity, Assignment Evaluation Forms, simple Expectations and Performance Achievement measurements, etc.

“*Change Management*” training should be presented to the affected parties as soon the Human Resources changes are announced. The effect of the changes and increased opportunities available should be clearly presented, as well as the handling of any negative impacts.

>Begin with announcement of Changes as above.

Consolidated database:

This is a major potential opportunity for bank supervision, CBBH and deposit insurance, i.e., the upgrading of IT technology and information database sharing.

Bank supervision could have a better database, with enhanced user-friendly bank performance monitoring and an early warning system. Deposit insurance could improve its ability to monitor insured banks and its exposure. And, CBBH could monitor certain banking data that it can use for macro-economic analysis.

A strategic IT steering group needs to be formed as soon as possible after the structural location decision is made. It needs to develop a strategic plan on how to reach the objectives of a shared database for each of the beneficiaries. An expert needs to assess and help lead this effort to develop or convert such a database and ensure its capability for the user needs.

Bring IT Expert and person knowledgeable about software to assess situation and determine the best way to consolidate databases or link via software. Some software is reportedly capable of operating from a variety of platforms via mapping. Expert would advise IT Strategic Steering Group, and IT and User staffs.

**>Begin Sept-Oct. 2003, depending on organizational decision and agreements.
(USAID BSP IT Expert and Software)**

An additional issue that could follow is a working group to review present reports from banks with objective being to reduce the number of reports and to make them more useful. DIA needs some specific info added. Membership would need to include bank representatives.

>Begin Nov-03 into Q1-04.

{Note: An incentive to banks to produce better and more accurate reports could be the reduction in reporting and paperwork, and the more efficient bank supervision capability and deposit insurance analysis efficiency holding down costs of supervision and insurance.}